



Analyses & Opinions

By Waldemar Guba

Which system of direct payments to farmers should Poland select: standard or simplified?

- The simplified system of direct payments is more advantageous for Polish farmers than the standard system because it provides for a more effective utilisation of the national envelope of direct payments in the first years of EU membership.
- Poland should decide which system to select as soon as possible, before the completion of accession negotiations. The selection of the simplified system should facilitate the task of reaching the Polish objective to change the initial proportion of the agricultural budget (between the first and second pillar of the Common Agricultural Policy) proposed by the EU with a view to raising the level of direct subsidies and better utilising the funds made available to rural areas and agriculture.
- The adoption by Poland of the simplified system of direct payments will contribute to the competitiveness of Polish agriculture better than the standard system.

Within the framework of the Common Negotiation Position on Agriculture, next to the negotiable proposals (such as the level of direct payments and production quotas), the European Union has provided the candidate countries with an opportunity to select between the standard and simplified system of direct payments.

Under the standard system currently applied in the EU, the level of direct payments depends on the arable land area, head of cattle and production volume. Under the simplified system, the overall financial envelope negotiated for the entire country would be divided between farms proportionally to the size of arable land, regardless of the type of agricultural production carried out thereon. A farm would not have to be engaged in production to receive simplified payments and neither would there be a requirement to set aside a part of arable land (currently 10%) by large farms (with over 92 tonnes of potential cereal output). Arable

land, nevertheless, would have to be maintained at an appropriate level of cultivation and in accordance with environmental protection requirements.

The candidate countries would be able to apply the simplified system for three years with a possibility of extension for two more years or switch over to the standard system even after a full year of utilising the simplified scheme.

Reasons behind the EU proposing the simplified system to the candidate countries

An analysis of the European Union proposal points to several main reasons for proposing the simplified scheme.

Firstly, taking into account its own experience in implementing and operating the standard system, the EU may suspect that Poland will not be able to reach a state of effective application of the standard system by the intended deadline (in terms of preparing its institutions and farmers alike). The level at which the candidate countries are able to absorb direct payments is particularly significant considering that their volume may be reduced in the first years of EU membership.

Secondly, in accordance with the proposals of the Agenda 2000 Mid-Term Review, it was expected that a similar simplified system would be adopted by the 15 Member States. In 2002, the EU had introduced a pilot "small-farmer scheme" for farms receiving no more than EURO 1250 in annual subsidies. The EU, however, stresses that should the standard system be adopted in Poland, its farmers would not be able to take advantage of this improvement owing to the absence of historical data on payment amounts disbursed to individual farms.

Thirdly, payments under the simplified system offered to the candidate countries would be classified within the WTO as decoupled from production and, hence, having a limited distorting effect on the terms of competition on international markets. The adoption of the simplified system by the candidate countries would make it easier for the EU to defend its current farm policy solutions in the forthcoming round of WTO negotiations on market liberalisation and agricultural trade.

New context of negotiations

The issue of direct-payment system selection has been given little attention during the public debate and the preliminary recommendations have been developed on the basis of extremely superficial review. This can be explained by the fact that the issue is not strictly a subject to negotiation and that the candidate countries have been offered the time up to accession to decide which system they select. It seems, however, that the situation has significantly changed in the light of the EU position forcing a low level of direct payments in the first few years after accession and the methods requested by Poland to soften the imbalance in market competition due to curtailed direct payments.

The Polish suggestion to modify the initial proportion between the first and second pillar of the Common Agricultural Policy is closely associated with the possibility of applying a simplified system of direct payments. One of the ways, indeed, of softening the imbalance in competition terms postulated by Poland is to bring closer the proportion of funds expended out of the proposed agricultural budget to the rates currently in place in the European Union. Funds earmarked for the second pillar of the Common Agricultural Policy (rural development measures, which are much more difficult to absorb) amount in the EU to c.a.10% of the budget, whereas in the proposed budget of Poland they amount to approximately 50%. The Polish proposal, therefore, aims not only at raising the level of direct payments (the most important element of CAP's first pillar) at the expense of a temporary reduction of the funds earmarked for the second CAP pillar and, first and foremost, at ensuring a full and effective absorption of funds earmarked for Polish agriculture and rural areas in the initial years of EU membership.

From an EU perspective, the postulated modification would probably be much more acceptable should Poland adopt the simplified system since the "reallocated" funds could continue being notified within the WTO framework as neutral to the terms of competition on international markets.

The simplified system will facilitate a fuller utilisation of assistance funds

The simplified system will facilitate a fuller utilisation of direct payments for the following reasons:

Even if IACS were completed at the projected date, Poland would still need time to become experienced in its operation under Polish conditions. This challenge would be much easier to deal with under the simplified scheme because, then, the administrative system would need to process a relatively small amount of information.

A major challenge for IACS in the initial years of the Polish membership in the EU may reside in a large number of flawed applications for payment that will require verification, correction and even rejection. In the EU, during the first year of IACS operation, the share of flawed applications for payment amounted to almost 70%. A simplified application will reduce that threat.

The experience acquired by those EU member states that have an agricultural structure similar to Poland's indicates that the level of utilisation of direct payments due under the standard system is far from full and amounts to 70-90% in the case of arable crops payments. Utilisation indicators for those countries are even lower as far as beef premia are concerned – less than 50%. Under the simplified system, the payment rate per hectare refers to the overall payment due to the entire country regardless of the actual production level.

The simplified system better contributes to the competitiveness of Polish agriculture

The discussion of the simplified system often highlights a fear that a certain type of farms will lose out on its introduction (compared to the standard system). This ensues from that fact that direct payments under the standard system support only certain types of production, and not all to the same extent. Farms specializing in production that strongly benefit from subsidies (cereals, tobacco, hops, beef) may "lose" some payments under the simplified system to the benefit of farms specializing in production supported only by high prices (milk, sugar beets), or supported only to a small extent or not at all (potatoes not for starch). Nevertheless, the effect of CAP support redistribution among farms will be much less significant than often assumed, mainly because the average level of farm specialization in

Poland is low – an average farm produces both crops that are supported and not supported by direct payments. The level of payments per farm effected in proportion to the arable land area will not change much. As SAEPR/FAPA studies show, production of tobacco and hops, which under the standard system benefit from high subsidy rates per hectare, may require additional compensation after switching over to the simplified system. Moreover, the assessment of that effect must not be based only on the current specialization of many Polish farms because it may largely reflect the specificity of the Polish agricultural policy pursued to date. OECD studies, for example, indicate that the level of Polish wheat and rapeseed production support in 2000/2001 (through market protection and direct subsidies) was more than twice the average level of support extended to domestic farmers.

What needs to be remembered before all else is that the application of the simplified system would not boil down only to changes in the principle of distributing the pool of funds available for direct support but would also bring about a rise of the global pool of economic benefits for the agricultural sector and individual farms. Besides a fuller utilization of domestic payment amounts, the following advantages should also mentioned:

- Proceeds from sales (or utilisation on farms) of additional crops yielded from that part of cultivable land that under the standard system would need to be set aside (excluded from production). These benefits will be almost totally shared among large commercial farms with a cereal production potential exceeding 92 tones and high actual cereal yield levels;
- Improved effectiveness of the utilization of the production resources by making production decisions independent from support restrictions and administrative requirements associated with the standard system. This positive effect will be felt mainly by commercial farms, which will be guided by the market signals to a much larger extent – at the same level of direct support as under the standard system;
- Benefits and savings for farmers resulting from simplified procedures associated with completing, submitting, verifying and correcting direct payment applications. These benefits and savings will be most important for small farms;
- Savings in the national budget resulting from the possibility of deferring by several years the investment and operating costs associated with the development and operation of certain IACS elements. The objective here is to evade a part of expenses and lighten the national budget burden in the most difficult initial years of Poland's membership in the EU.

It is not true that the adoption of the simplified system will favour farms that produce for their own needs at the expense of intensive and commercial farms, thus petrifying the structure of the agricultural sector. Such an assertion is based on a false assumption that the simplified system takes funds away from large and intensive farms and transfers them to farms that are small and extensive. It should be stressed that benefits expected from the simplified system in the form of a larger number of farms receiving direct payments would be achieved thanks to funds that under the standard system would not reach Poland at all.

Finally, two significant aspects should be mentioned when discussing which direct payment system Poland should select. The first is associated with the role played by the balance of payments between the EU budget and Poland in the public debate on the consequences of the first few years of Poland's membership in the Union. EU negotiation proposals to date (a full membership fee paid into the EU budget jointly with a major reduction of easily absorbable transfers) constitutes a serious threat in that Poland may initially pay more into than receive from the EU budget. This threat can be reduced by ensuring a fuller utilisation of funds earmarked for agriculture thanks to the simplified system and initial modification of the expense structure. A second aspect lies in increasing, through the simplified system, the number of CAP beneficiaries in Poland by several hundred thousand farms (uniquely as a result of giving them access to funds that would not be utilized under the standard system), which may have great significance (be it only psychological) on shaping an participatory attitude among the rural population with respect to the accession process.

WALDEMAR GUBA works at the Agricultural Policy Analysis Unit (*Sekcja Analiz Ekonomicznych Polityki Rolnej*) of the Foundation for Assistance Programmes for Agriculture (*Fundacja Programów Pomocy dla Rolnictwa - SAEPR/FAPA*). He collaborates with the Institute of Public Affairs.

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